



CITY OF LODI

COUNCIL COMMUNICATION

AGENDA TITLE: Discussion Regarding Proposed Audit (Agreed-Upon Procedures) of Envision Law Group by the City's Auditor

MEETING DATE: November 5, 2003

SUBMITTED BY: Janet S. Keeter, Deputy City Manager

RECOMMENDATION: That Council Member Hansen lead the Council in a discussion regarding his proposed "audit" of the Envision Law Group's billings and take appropriate action.

BACKGROUND INFORMATION: During the October 15, 2003 City Council meeting, Council Member Larry Hansen requested that Council consider conducting an "audit" of the Envision Law Group's billings for the PCE/TCE litigation matter. His request was made during Council Comments and is now coming before Council for discussion as an agenda item.

Council Member Hansen will lead the discussion regarding his request and has prepared background information (Exhibit A) and a copy of e-mail correspondence between Finance Director Vicky McAthie and Scott Brunner, Director of the City's auditing firm Macias, Gini & Company (Exhibit B) for Council's information.

Funding: Not applicable

Respectfully submitted,

A handwritten signature in cursive script that reads "Janet S. Keeter".

Janet S. Keeter
Deputy City Manager

Attachments

APPROVED: _____

A handwritten signature in cursive script that reads "H. Dixon Flynn".

H. Dixon Flynn -- City Manager

BACKGROUND INFORMATION: One of the issues raised by the media and many concerned citizens is the approved expenditures of the Envision Law Firm and the many questions about how the City's money is being spent. At the October 15th Council meeting, Council Member Larry Hansen requested that the City find a means to have the City financial records audited. It was discussed whether to use an attorney or to use the City auditors to conduct the audit.

On October 16th, our Finance Director, Vicky McAthie sent an e-mail to Scott Brunner, a CPA and Director of our current auditing firm. The original e-mail from Ms. McAthie and Mr. Brunner's response are attached to this communication. Mr. Brunner suggested that rather than an audit per se, we might want to consider an "Agreed Upon Procedures Engagement". This type of procedure is one in which the auditor is engaged to perform specific procedures and report the findings. The auditor does not perform an examination or provide an opinion. Rather the auditor reports only procedures and findings which are very specific and concise. The procedure should generally meet the following two tests:

- They should address the nature, timing and extent.
- They should result in findings that are capable of reasonably consistent estimation or measurement.

An agreed upon procedure might focus on the following three specific areas of concern: related documents, expenditures and receipts.

Related documents:

- Review agreement signed with Envision Law and USF&G re: reimbursement for expenditures, agreed upon rates and agreed upon deductions.
- Review agreement with Lehman financing and quarterly caps set forth in the Program Receipts Sale and Repurchase Agreement.
- Review Court's February 28, 2003 agreed order re: USF&G's duty to defend and to whom payments should be made.
- Review where Wells Fargo Bank statements are going.

Expenditures:

- Review expenditures vs. industry standard.
- Review expenditures and invoices sent to USF&G.

Receipts:

- Review receipts received from USF&G focusing on:
 - Ongoing defense costs or recoveries subject to Lehman Financing Agreement.
 - What parsing out is done to make sure the City of Lodi meets its obligations to the holders of the COP under the Lehman financing and Envision Law Group, LLP.
- Review payments received by Envision Law: when received and when released to the City, and determine any interest due to the City.
- Review advance from USF&G for the Environmental Site Investigation and how that is associated with Lehman financing receipts applied to DTSC reserve.
- Review any non-cash payments received and the impact that they would have on the Lehman financing.

EXHIBIT B

Subj: RE:
Date: 10/16/03 4:42:00 PM Pacific Daylight Time
From: sbrunner@maciasgini.com
To: vmcathie@lodi.gov
CC: CityCouncil@lodi.gov, sblackston@lodi.gov, jkeeter@lodi.gov, rhays@lodi.gov

Hi Vicky,

In know this is long, but the more information you have the greater the likelihood that we get this process off on the right foot.

This type of engagement isn't really an audit, per se. It sounds as though what you're looking for is what's called an agreed-upon procedures engagement. I know it's only a technicality as non-auditors generally call an agreed-upon procedures engagement an audit as it's conducted by auditors, but I want to make the distinction clear. As an audit report states, "an audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation." An agreed-upon procedures engagement is one in which the auditor is engaged to perform specific procedures and report findings. The auditor does not perform an examination or provide an opinion. Rather, the auditor reports only procedures and findings.

In other words, an audit is very broad and not absolute or exact, hence an opinion is given. In an audit, it is up to the auditor's discretion of what procedures to perform in order to provide the opinion. An agreed-upon procedures engagement is very specific and concise. The client provides the auditor with the very specific procedures they'd like performed, and the auditor reports what exactly they did or did not find. Nothing's left up to the auditor for interpretation, not even materiality.

However, before we can quote you a fee, we need to know how long the engagement will take. And before we can determine how long the engagement will take, we need to know very specifically the procedures you'd like performed. The following are some guidelines you should follow in developing the procedures you'd like performed:

Examples of procedures that would generally be considered appropriate for an agreed-upon procedures engagement include the following:

- Inspecting specific documents for evidence of certain types of transactions or characteristics.
- Comparing certain documents, schedules, or analyses with specific attributes.
- Performing agreed-upon mathematical computations.
- Executing a sample application after agreeing on relevant parameters.
- Confirming specific information with third parties.

To be appropriate, procedures should generally meet the following two tests:

- They should address nature, timing, and extent.
- They should result in findings that are capable of reasonably consistent estimation or measurement. In other words, for a procedure to be appropriate, the auditor should be able to demonstrate that they accomplished it.

In an agreed-upon procedures engagement, the auditor may generally perform any procedures requested provided the procedures are not overly subjective, described in an unclear manner, or open to varying interpretation. This is because the auditor's report should clearly list and describe the procedures performed. Examples of procedures that are not sufficiently clear include:

- Performing a "general review" of the company's accounts receivable.
- "Checking" the company's inventory balances.
- "Reconciling" the company's cash accounts.
- "Testing" the company's accounts payable balances.

- Performing a "limited review" of the company's cash accounts.

Use of vague terms such as these should generally be avoided. If they must be used, they should be accompanied by an explanation of what procedures are meant by the terms. In addition to procedures that are described in a vague or unclear manner, the following procedures would normally also be considered inappropriate because they do not result in findings that are meaningful:

- Mere reading of the subject matter. (However, reading the subject matter is appropriate if it is performed in addition to other procedures.)
- Mere reading of the work performed by others solely to describe their findings.
- Evaluating the competency or objectivity of another party.
- Obtaining an understanding about a particular subject.
- Interpreting documents outside the scope of the auditor's professional expertise.

This should give you some good information to take back to the City Council to determine what exactly you'd like us to do. Once that's determined, we can determine what it will take and cost. Please let us know if we can be of any further help.

Thank you,

Scott A. Brunner, CPA
Director
Macias, Gini & Company LLP

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-----Original Message-----

From: Vicky McAthie [mailto:vmcathie@lodi.gov]
Sent: Thursday, October 16, 2003 11:14 AM
To: sbrunner@maciasgini.com
Cc: City Council; Susan Blackston; Janet Keeter; Randy Hays
Subject:

Scott,

As you are aware there has been a lot of discussion on the PCE/TCE legal issue. Last night at the Council meeting, one of the Council members asked about the feasibility of the city audit firm auditing the outside legal firm's books for reasonableness of the bills they submit to the City for payment. Questions have been raised about what the industry practice is for charges for items such as limo, meals etc.

This of course was not part of the scope of our annual audit so we would also like to get an estimate of charges for this type of audit. The scope of the audit may also include auditing of payments received by Envision Law for the City of Lodi, the audit of any reduction of those payments for Envision Law invoices that are above the cap allowable by the formula used for the request for funds from the financing, the timing of those payments to the City, and any interest accrued/due the City. I have a copy of questions of this nature that I have asked Envision Law and the responses they have sent me. I can make this available to you for your audit work papers.

Please let me know if this is something your audit firm would be able to take on, and if so what an estimate of the charges for this type of audit would be. If your firm is not able to take this on currently, please let me know if you can recommend another audit firm with expertise in this area.